

ECONOMIC OUTLOOK

NATIONAL ECONOMY AND KEY POINTS FROM THE GLOBAL INSIGHT OUTLOOK

The national economy grew slowly following the recession in 2001. In FY/04 a turnaround began, spurred in part by federal tax cuts. The third quarter of calendar year 2003 showed an increase of 7% in real gross domestic product (GDP) and increases in employment. FY/04 had real GDP growth of 4.1%, and FY/05 followed with growth of 3.7%. The Federal Reserve Board (FRB) began increasing rates at the beginning of FY/05 on fears of inflation. The increases in energy prices substantially increased inflation, as measured by the consumer price index (CPI), though core inflation (CPI excluding food and energy) remained moderate. For FY/05 inflation as measured by the CPI averaged 3% and for FY/06 it is expected to grow to 3.6%. Oil prices (West Texas intermediate) averaged \$23.80 per barrel in FY/02 and grew to \$48.80 per barrel average in FY/05. The average for FY/06 is expected to be \$60.21 per barrel. Global Insight (GI) sees these prices tapering off, with \$57.18 per barrel in FY/07 moving down to \$50.88 per barrel by FY/10. The long term outlook for oil prices is substantially higher than past forecasts. Still, inflation remains under control even with the large increases in oil prices. Helped by decreases in the price of oil, GI expects the CPI to increase 1.8% in FY/07 and stay around 2% through FY/10.

The fourth quarter of 2005 posted slower than expected growth. The impact of hurricanes Katrina and Rita were in part responsible, but this slowdown will be offset by construction activity in the second half of the fiscal year. The impacts on energy prices are expected to be short-term, but will have a substantial impact on natural gas prices for the FY/06 heating season. Energy spending as a percent of disposable income is expected to increase from 4.8% in early 2005 to 6% at the beginning of FY/06. This ratio is expected to decline back to 4.8% by 2007.

GI also presents risks to the forecast in the form of optimistic and pessimistic scenarios. The pessimistic scenario, assigned a probability of 25%, assumes that the economy will be hit by a stagflation. This assumes that oil prices go higher with oil hitting \$80 per barrel in the middle of FY/06 and declining only to \$55 per barrel. Real GDP declines to 1.4% in the middle of FY/06 and recovers for a couple quarters then drops to 1% for the middle of FY/07. This is driven in part by increases in inflation fed by high oil prices and the weak dollar. Inflation doesn't slow as much as in the baseline with the CPI remaining closer to 3%. The Federal Reserve Bank (FRB) reacts to inflation pushing up interest rates to 7.4% in 2008. Higher interest rates slow the housing market substantially. Unemployment increases, hitting a high of 6% in 2008.

The optimistic scenario where "everything goes right" is assigned a probability of 20%. In this scenario, productivity is stronger than the baseline, helping strengthen GDP and weaken inflationary pressures. GDP has stronger growth driven by productivity increases, which helps both inflation and budget deficits. The optimistic scenario is only slightly better than the baseline, while the pessimistic scenario has a strong impact on the economy.

Gross Domestic Product (GDP)

In FY/03 the economy rebounded slowly to post a 1.9% growth rate. Growth increased to 4.1% in FY/04 and 3.7% in FY/05. Growth is expected to slow to 3.6% in FY/06 and 3.0% in FY/07. Growth remains at about this level for the remainder of the forecast.

Employment and Productivity

As the economy moved into recession, unemployment jumped from the historically low rates of around 4% from FY/99 to FY/02, to 5.9% in FY/03, and 5.8% in FY/04. Unemployment in FY/05 declined slightly to about 5.3% and declines to under 5% in FY/07 and stays at this level for the

remainder of the forecast. Employment growth has made some increases recently, but was near zero in FY/04. FY/05 had growth of 1.6% and FY/06 should have growth around 1.5%. Growth is expected to slow only slightly for the remainder of the forecast. FY/04 showed strong productivity growth of 4.7% in output per hour, declined to 2.5% in FY/05, increasing to 3% for FY/06 before declining to 2.1% in FY/07 and growing slightly for the remainder of the forecast.

Inflation

As measured by the consumer price index for urban consumers, inflation was low, around 2%, for the period FY/02-FY/04. In FY/05 inflation jumped to 3% driven largely by oil price increases. Energy prices continued to push up inflation and FY/06 is expected to increase to 3.6%, then decline to 1.8% in FY/07, and remain around 2% for the remainder of the forecast. Inflation is held in check with little wage pressure as employment grows slowly and productivity increases hold costs down.

Interest Rates

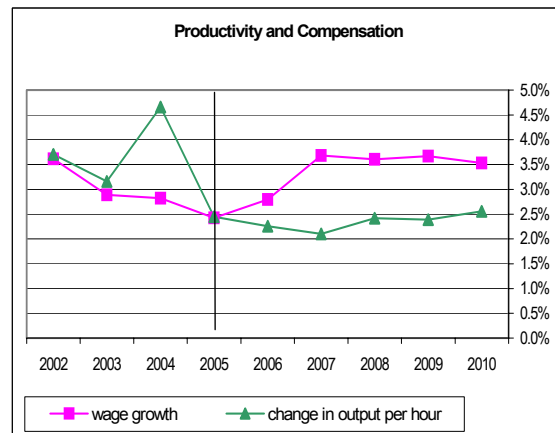
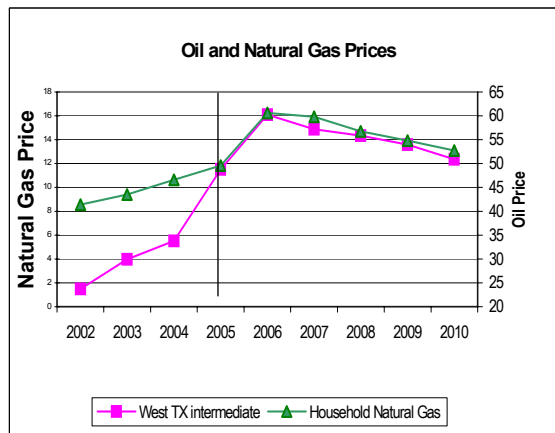
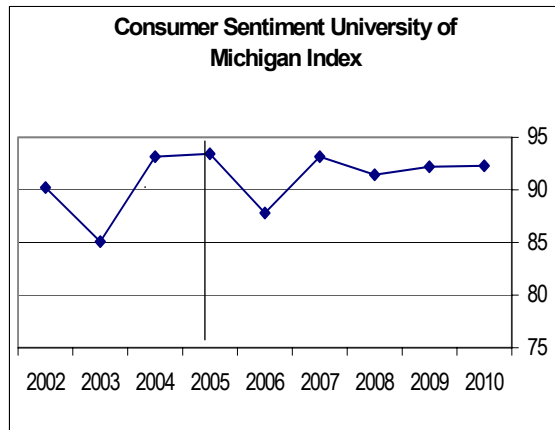
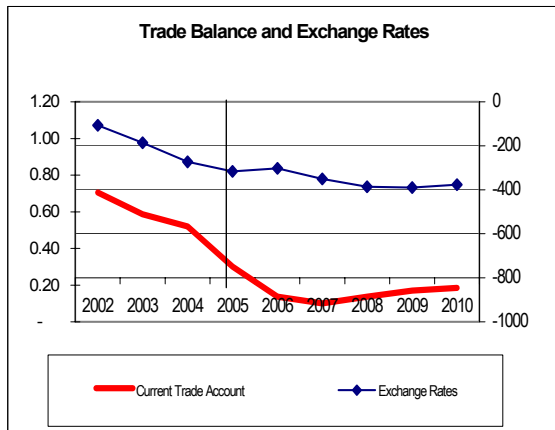
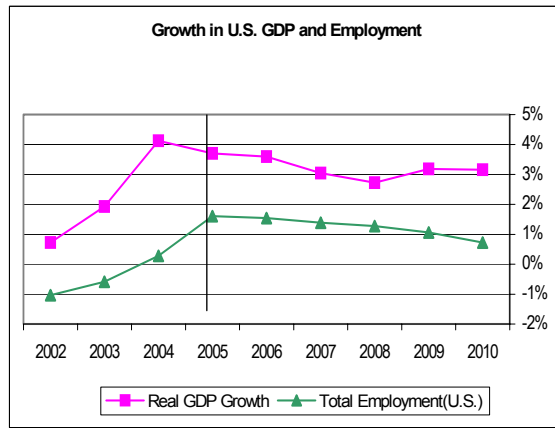
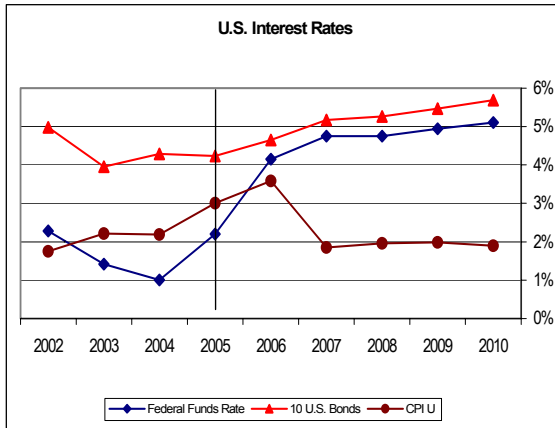
After cutting the federal funds rate to 1%, the lowest level since the 1960s, the FRB increased rates twice in 2004 and continued to increase throughout FY/05. Rates averaged 2.2% for FY/05 but were 4% at the end of the fiscal year and were 4.5% by December 2005. It is expected that the FRB will increase rates to 5% raising the rate by 1/4% at the next two meetings at the end of March 2006 and May 2006. Long term rates also grow, but slower than the short term rates. The rates are still quite low historically.

World Economy

GI believes that the world economy will continue to grow at a slow rate. The dollar will continue to weaken. The current trade account deficit was \$752 billion in FY/05, and is expected to increase to \$928 billion in FY/07 then slowly come down to \$889 billion by FY/10. Slower growth in the rest of the world would lower export growth, hurt the U.S. economy and increase the existing trade imbalance.

U.S. ECONOMIC VARIABLES AND FORECAST (FISCAL YEAR)

January 2006 Baseline Forecast



ALBUQUERQUE ECONOMY

The situation in the Albuquerque economy is similar to the nation as a whole. Although Albuquerque has increased employment, the growth rates through FY/05 are moderate. The unemployment rate in Albuquerque increased from around 3% in FY/01 to 5.4% in FY/04. The unemployment rate declined to 5.2% in FY/05 and is expected to edge down to 5.1% in FY/06, and remain near this for the remainder of the forecast. The Albuquerque economy continues to grow, with increases in growth in FY/07 from continued strong construction and a turnaround in manufacturing job growth.

The classification of industries has changed with a movement from the Standard Industrial Classification (SIC) code system to the new North American Industrial Classification System (NAICS). This system provides a framework for classification of industries that is the same for all of North America and updates some of the definitions for newer industries. While the largest sectors in the Albuquerque economy were trade (retail and wholesale) and services under the SIC definition, these sectors were broken up and the distinctions are now quite different. For instance, retail trade under the SIC classification included eating and drinking establishments. The “eating and drinking” category is now included in the hospitality sector that also includes hotels (this was in the service sector under SIC code). A table at the end of this section provides sector employment numbers for FY/01 to FY/10 by the NAICS categories.

Trade Transportation and Utilities. This sector has posted slow growth and from FY/01 to FY/05 lost 125 jobs. The largest piece—retail trade—gained 1,475 jobs but this was almost totally offset by losses in wholesale trade. Transportation and utilities lost 185 jobs in the same period. A large part of this was the loss of approximately 75 workers at the local gas and electric utility in 2003. The forecast has moderate growth in this sector with an average annual growth rate of 1.5%.

Manufacturing. This sector accounted for 8.5% of employment in 1993 declining to 6% in FY/05. Employment peaked in FY/98 at 28,342, declining to 22,617 in FY/05, a loss of over 5,500 jobs. Still the manufacturing sector has held up better in Albuquerque than it has in the U.S. economy. These job losses were due first to the Asian financial crisis of 1998, which hit telephone manufacturing and hurt the local employment of Motorola and Philips. Motorola sold what little manufacturing capacity it had left in 1999 and Philips closed its plant in October 2003. Intel, after expanding in 1995, has held employment rather constant despite a \$2 billion expansion in 2002. The employment declines slowed some in FY/04 but still suffered a loss of 5.6%. In FY/05 employment losses slowed to 0.7%. This is expected to turn in the forecast with FY/06 growth of 2.8%, and FY/07 growth of 6.7% and 2.7% in FY/08. The growth is expected to come from outside the computer and semiconductor area. Growth in manufacturing includes jobs from the TempurPedic mattress factory, Eclipse Aviations (which is adding jobs sooner than expected), Merrilat Industries in Los Lunas, Superior Micropowder, Advent Solar, and American Utilicraft. Although Intel adds jobs, the computer and electronics sub-sector continues to show job losses.

Educational and Health Services. Albuquerque is a major regional medical center. Presbyterian Hospital and its HMO are one of the largest employers in the area. This is one of the fastest growing categories in the MSA economy. In the past 10 fiscal years this sector had average growth of 4.2%. In FY/04 growth was 4.1% and in FY/05 it was 5.9%. In FY/06 growth is expected to slow to 2.5% and remain near this level of growth for the remainder of the forecast.

Leisure and Hospitality. This category includes eating and drinking establishments as well as hotels and other travel related facilities. Employment growth was only 1.3% in FY/03 but FY/04 had growth of 2.7%. In FY/05 the sector showed no growth in employment, and decreases in food services employment. The lodger's tax for the City showed a somewhat different picture.

After declining 2% in FY/02 and remaining flat in FY/03 lodger's tax showed growth of 4.9% in FY/04 and 3.2% in FY/05. Mid-year FY/06 shows growth of 8% so the lodging sector is showing some strong activity. Average employment growth for the forecast period is expected to be 1.5%.

Financial Activities. This sector includes finance and insurance including credit intermediation. The employment in this sector declined from FY/01 to FY/05, despite an increase of 1.9% in FY/05. Average growth for the sector is expected to be an anemic 0.8% for FY/06 to FY/10.

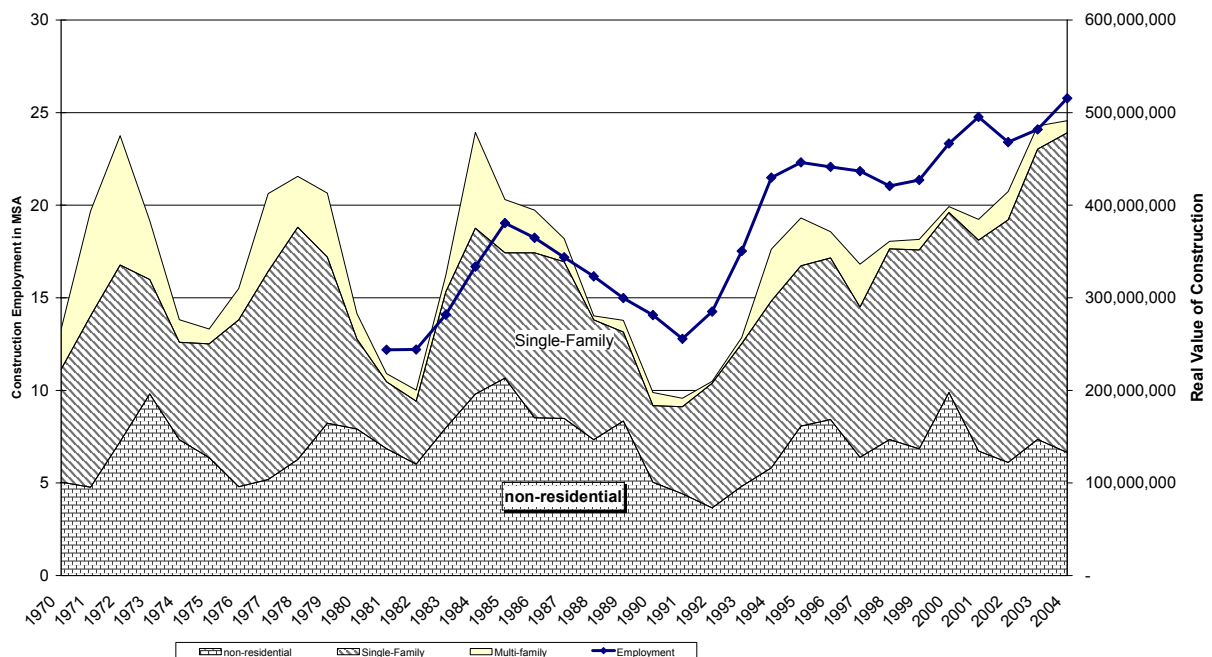
Professional and Business Services. This sector includes temporary employment agencies and some of Albuquerque's back-office operations. It also includes Sandia National Labs (SNL). This sector had average annual growth of 0.3% from FY/01 to FY/05, but showed a strong turnaround in FY/05 with 3% growth. In the forecast period growth is expected to average 2.2%.

Information. This sector includes businesses in publishing, broadcasting, telecommunications, and internet service establishments. This sector was very strong in the 1990s but suffered a decline of 7.5% in FY/03 and 5.1% in FY/04. This trend continues with an expected decline of 10.2% in FY/05. The most recent decline is primarily from layoffs at the MCI call center of about 880 jobs. The sector is expected to rebound and with new call centers is forecast to grow at an annual average rate of 3.9% in the forecast period.

Construction

Construction is typically cyclical, with large swings in building and employment. The following chart shows the real value of single-family, multi-family, and non-residential new permits from 1970 to 2004 (deflated by the CPI; 100=1982-84). Four distinct peaks occur in 1973, 1979, 1985 and 1995. There was only a slight decline from the 1995 peak and the real value of construction since then has exceeded this level. The increase is driven primarily by residential construction. Commercial construction in real terms has remained relatively flat and the total annual value of construction has not reached any of the previous peaks. In the past the cycles were accentuated by large buildups of multi-family housing, in part, to capture tax breaks that are no longer available. After overbuilding, vacancy rates would increase dramatically and apartment building would cease for several years. Since 1995, single-family construction has made up a larger share of total construction and multi-family construction has remained subdued. In 2004 the real value of single family housing increased, but the number of units permitted actually declined about 0.5%. The value of single family permits per home increased by 27%.

Construction Values In City of Albuquerque Deflated by CPI
and Construction Employment in the MSA in Thousands



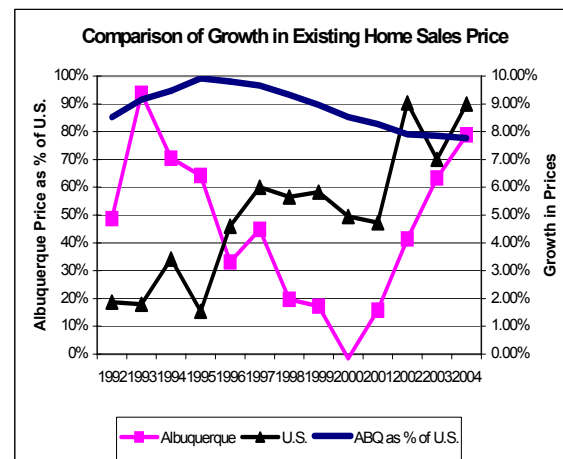
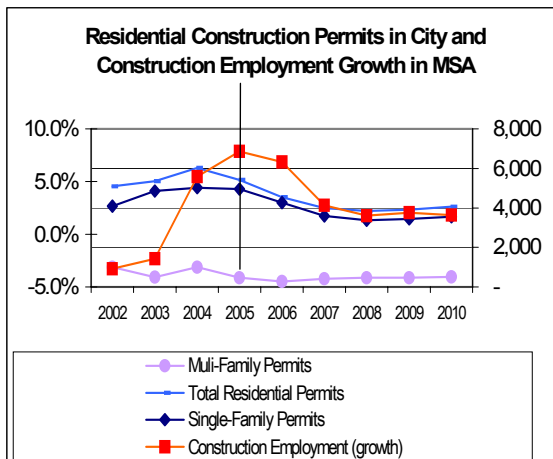
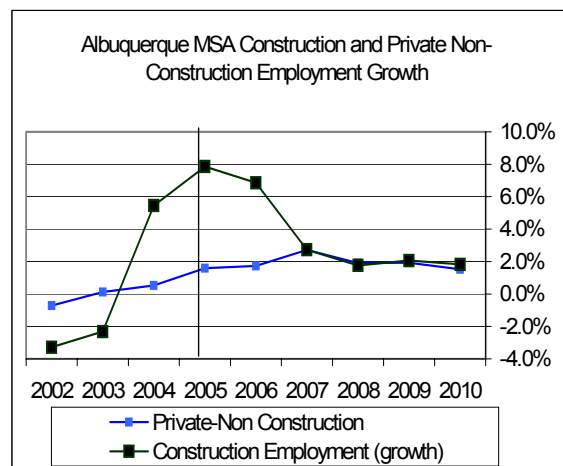
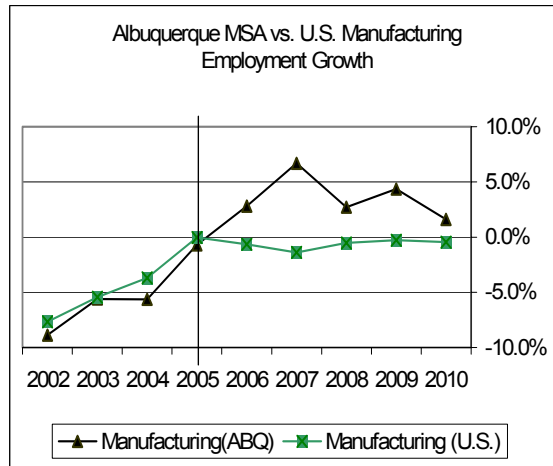
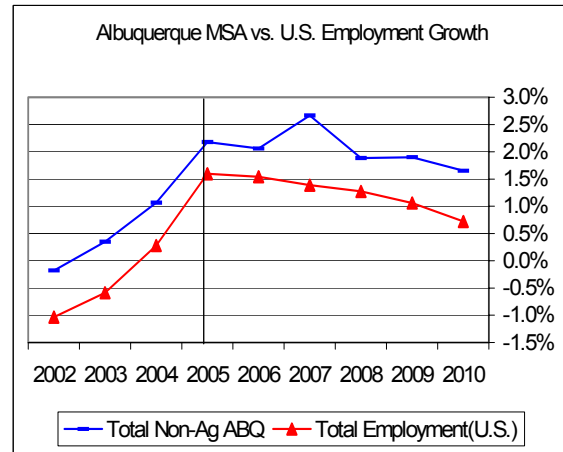
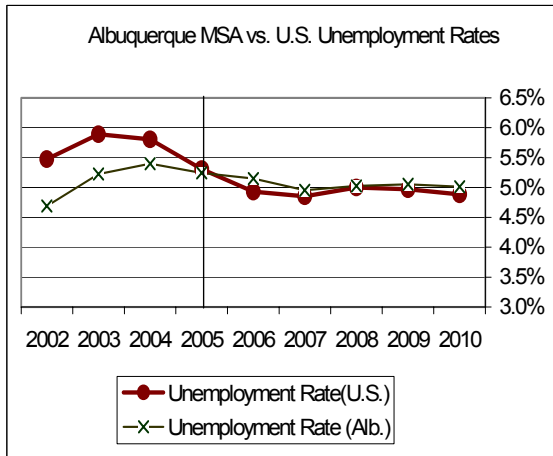
Employment in the construction sector was very strong in 2000-2002, driven, in large part, by the Intel project and the Big-I reconstruction project. The Big-I was completed ahead of schedule in June 2002, and the Intel project was finished in June of 2002. As these jobs were lost we saw a reduction in employment in FY/02 and some additional losses in FY/03. In FY/04 growth was 5.5% and in FY/05 employment growth was 7.9%. Growth is expected to slow but remain high at 6.9% in FY/06 slowing to 2.7% in FY/07. The remainder of the forecast has growth around 2%. Even so, the level of employment in the sector remains above historical levels. Permitting at the City, particularly residential, is expected to decline substantially with building permits declining. Additionally, many of the large roads and City public works projects will be completing or completed by FY/07. Large projects currently under way such as, University Hospital, Coors I-40, and the I-40 widening and repaving will be completed before FY/07. Additionally, the City had a back log of capital projects that was mostly completed in FY/05.

The City information on permits does not include several important measures of construction. It does not include projects built by the State of New Mexico, the federal government, construction of roads, or water/sewer systems. All of these projects generate gross receipts tax revenues.

LOCAL ECONOMIC VARIABLES HISTORY AND FORECAST

By Fiscal Year BBER FORUNM January 2006

Baseline



Employment by NAICS Categories (In Thousands)

	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010	Avg. annual Growth 2001 to 2005	Avg. annual Growth 2006 to 2010	Growth 2006	Growth 2007
Total nonagricultural	361.78	361.15	362.42	366.28	374.27	381.97	392.16	399.56	407.15	413.89	0.9%	2.0%	2.1%	2.7%
Natural resources and mining and construction	24.88	24.06	23.50	24.78	26.73	28.57	29.35	29.86	30.48	31.04	1.8%	2.1%	6.9%	2.7%
Manufacturing	28.06	25.57	24.13	22.78	22.62	23.26	24.81	25.49	26.59	27.02	-5.2%	3.8%	2.8%	6.7%
Computer and electronics manufacturing	12.35	11.26	10.41	9.59	9.15	9.23	8.86	8.10	8.06	8.00	-7.2%	-3.5%	0.8%	-3.9%
Wholesale trade	14.08	13.59	13.23	12.93	12.66	12.87	13.09	13.23	13.38	13.51	-2.6%	1.2%	1.7%	1.7%
Retail trade	41.80	41.49	42.08	42.48	43.28	44.07	44.98	45.83	46.40	46.89	0.9%	1.6%	1.8%	2.1%
Transportation, warehousing, and utilities	10.63	10.56	10.61	10.51	10.44	10.43	10.57	10.72	10.89	11.06	-0.4%	1.5%	-0.1%	1.3%
Information	11.23	11.40	10.54	9.90	8.89	8.79	9.43	9.75	9.99	10.25	-5.7%	3.9%	-1.2%	7.3%
Financial activities	19.63	19.12	18.85	18.97	19.33	19.73	19.89	20.10	20.31	20.60	-0.4%	1.1%	2.1%	0.8%
Professional, scientific and technical services	26.86	26.96	27.77	28.26	29.21	29.95	30.70	31.29	31.89	32.46	2.1%	2.0%	2.5%	2.5%
Management/administrative/support	32.23	31.00	29.89	29.86	30.64	30.98	31.78	32.39	33.28	34.06	-1.3%	2.4%	1.1%	2.6%
Educational and health services	38.03	40.39	42.04	43.78	46.38	47.53	48.79	49.99	51.14	52.07	5.1%	2.3%	2.5%	2.6%
Leisure and hospitality	34.03	34.39	35.31	36.25	36.26	36.80	37.69	38.22	38.60	39.00	1.6%	1.5%	1.5%	2.4%
Food services and drinking places	26.23	26.68	27.38	28.16	27.98	28.38	29.03	29.43	29.76	30.10	1.6%	1.5%	1.4%	2.3%
Other services	11.05	11.24	11.61	11.75	12.01	12.00	12.21	12.39	12.52	12.60	2.1%	1.2%	-0.1%	1.8%
Government	69.31	71.38	72.85	74.05	75.83	77.02	78.90	80.32	81.73	83.38	2.3%	2.0%	1.6%	2.4%
Local government	33.18	34.79	35.57	36.16	37.53	38.07	39.30	40.20	41.13	42.12	3.1%	2.6%	1.4%	3.2%
State government	22.33	22.66	23.13	23.85	24.26	24.65	25.21	25.67	26.07	26.47	2.1%	1.8%	1.6%	2.3%
Federal government	13.80	13.93	14.15	14.04	14.03	14.30	14.39	14.46	14.53	14.79	0.4%	0.8%	1.9%	0.6%
Military employment, thousands	6.44	6.49	6.63	6.71	6.76	6.76	6.75	6.74	6.73	6.72	1.2%	-0.1%	-0.1%	-0.1%

January 2006 FOR-UNM Baseline Forecast

Economic Variables Underlying the Forecast by Fiscal Year

	Historical				Forecast				
	2002	2003	2004	2005	2006	2007	2008	2009	2010
National Variables									
Real GDP Growth	0.7%	1.9%	4.1%	3.7%	3.6%	3.0%	2.7%	3.2%	3.2%
Federal Funds Rate	2.3%	1.4%	1.0%	2.2%	4.2%	4.8%	4.8%	4.9%	5.1%
10 U.S. Bonds	5.0%	4.0%	4.3%	4.2%	4.6%	5.2%	5.3%	5.5%	5.7%
CPI U	1.8%	2.2%	2.2%	3.0%	3.6%	1.8%	2.0%	2.0%	1.9%
Unemployment Rate(U.S.)	5.5%	5.9%	5.8%	5.3%	4.9%	4.9%	5.0%	5.0%	4.9%
Employment(Total non-farm)	-1.0%	-0.6%	0.3%	1.6%	1.5%	1.5%	1.2%	1.1%	1.0%
Employment (Manufacturing)	-7.7%	-5.4%	-3.7%	0.0%	-0.3%	-1.0%	-0.7%	-0.4%	-0.4%
Consumer sentiment index--University of Michigan	90.2	85.1	93.2	93.4	87.8	93.2	91.4	92.2	92.3
Exchange Rates	1.07	0.98	0.87	0.82	0.84	0.78	0.74	0.73	0.75
Current Trade Account	(412.8)	(511.3)	(567.0)	(751.8)	(866.8)	(927.7)	(915.6)	(886.1)	(888.6)
Wage	3.6%	2.9%	2.8%	2.4%	2.5%	3.1%	3.3%	3.4%	3.4%
Output per hour	3.7%	3.2%	4.7%	2.5%	3.0%	2.1%	2.0%	2.4%	2.5%
Albuquerque Variables									

Employment Growth and Unemployment in Albuquerque MSA

Total Non-Ag ABQ	-0.2%	0.4%	1.1%	2.2%	2.1%	2.7%	1.9%	1.9%	1.7%
Private-Non Construction	-0.7%	0.1%	0.5%	1.6%	1.7%	2.7%	1.9%	1.9%	1.5%
Construction Employment (growth)	-3.3%	-2.3%	5.5%	7.9%	6.9%	2.7%	1.8%	2.1%	1.8%
Manufacturing(ABQ)	-8.9%	-5.6%	-5.6%	-0.7%	2.8%	6.7%	2.7%	4.3%	1.6%
Unemployment Rate (Alb.)	4.7%	5.2%	5.4%	5.2%	5.1%	5.0%	5.0%	5.1%	5.0%

Construction Units Permitted in City of Albuquerque

Single-Family Permits	4,087	4,855	5,029	4,953	4,271	3,591	3,373	3,440	3,548
Multi-Family Permits	1,002	493	1,000	466	274	408	464	468	510
Total Residential Permits	5,089	5,348	6,029	5,419	4,545	3,999	3,837	3,908	4,058

Source Global Insight and FOR-UNM January 2006 Baseline Forecasts